Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
	)	
Inter-Carrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68
	)	

REPLY COMMENTS OF AT&T CORP.

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Pursuant to the Commission's Public Notice, FCC 00-227, released June 23, 2000, AT&T Corp. ("AT&T") respectfully submits these reply comments on the standards that should be adopted to govern inter-carrier compensation for traffic bound for Internet Service Providers ("ISPs") under the terms of the Act and the D.C. Circuit's decision in *Bell Atlantic Tel. Cos.* v. *FCC*, 206 F.3d 1 (D.C. Cir. 2000).

INTRODUCTION AND SUMMARY

The comments overwhelmingly confirm that the Commission should ensure that all LECs pay reciprocal compensation for ISP-bound traffic at the rates established for other voice and data traffic. No commenter has established that there are any categorical cost differences between ISP-bound traffic and other concededly local traffic, and the Commission should adhere to its original conclusion in the *Local Competition Order* that reciprocal compensation should be paid at the same rate for all categories of traffic.

First, the commenters are almost unanimous that ISP-bound traffic is jurisdictionally interstate. No one disputes that, when evaluated under the courts' and the

Commission's traditional end-to-end test, ISP-bound traffic terminates predominantly at distant, out-of-state websites. Therefore, ISP-bound traffic falls squarely within the Commission's longstanding jurisdiction over interstate communications.

As many commenters acknowledge, however, and as the D.C. Circuit held, the mere fact that ISP traffic is jurisdictionally interstate does not mean that section 251(b)(5)'s obligation to pay cost-based reciprocal compensation for such traffic does not apply. This is true for two reasons. First, as a number of commenters point out (and as no other commenter disputes), section 251(b)(5) by its plain terms imposes the reciprocal compensation obligation on all "telecommunications," not just "local" traffic (as the Commission erroneously concluded in the *Local Competition Order*). The comments confirm that the Commission should now clarify that reciprocal compensation for ISP-bound traffic is governed by section 251(b)(5)'s requirements. Second, under the FCC's longstanding ESP exemption – which the FCC expressly indicated it would not reconsider in this proceeding – ISP traffic is *treated* as local for virtually every other purpose, including tariffing, ratesetting, and separations. As the commenters note, consistency requires the Commission to treat ISP traffic as local for purposes of reciprocal compensation in the event the Commission continues to imply a "local" limitation.

Finally, the comments confirm that CLECs use the same facilities and incur the same costs when delivering traffic to an ISP as they do when delivering other calls, and thus the compensation for ISP-bound traffic should be the same as for all local traffic. The incumbent LECs' contrary arguments are not only unsubstantiated on this record, they are beside the point. The comments reinforce the Commission's original conclusion in *Local Competition Order* that compensation paid to CLECs should be based on the incumbent LEC's forward-looking costs. This rule provides beneficial incentives to peform the terminating function more efficiently. And

nothing prevents the incumbents from improving their own efficiency to win back business in the inbound calling market. The incumbent LECs' attempts to cut off reciprocal compensation for ISP traffic is simply an ill-disguised attempt to win protection from this competition. In all events, the ILECs have not established *any* categorical cost differences between ISP traffic and other traffic. Most of the "cost" issues are not even ISP-specific, and chould support changes, if at all, that would apply to all traffic.

I. ISP-BOUND TRAFFIC IS JURISDICTIONALLY INTERSTATE.

There is a near consensus that ISP-bound traffic is jurisdictionally interstate. As almost every commenter notes, "[t]he D.C. Circuit did not question the FCC's ability to retain jurisdiction over dial-up ISP-bound traffic."[1] And the vast majority of commenters agree that "[t]he Commission correctly applied its end-to-end analysis in concluding that ISP-bound calls are jurisdictionally interstate."[2]

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[1] ALTS at 5. *See also, e.g.,* Qwest at 4 n.3 (noting that "the D.C. Circuit never questioned the Commission's use of its end-to-end analysis to establish its *jurisdiction* over ISP-bound traffic"); ALTS at 5-6 (the "D.C. Circuit did not question the FCC's ability to retain jurisdiction over dial-up ISP-bound traffic," and agreeing with the Commission's "conclusion that dial-up ISP-bound traffic is jurisdictionally interstate"); Advanced Telecom at 2-3 ("The D.C. Circuit did not see, and indeed dismissed, the relevance of the Commission's jurisdictional analysis to the resolution of whether dial-up calls to ISPs are subject to reciprocal compensation under Section 251(b)(5)").

[2] USTA at 5 (footnotes omitted). *See also, e.g.,* SBC at 9-10 ("For over fifty years, the Commission and the courts have unfailingly adhered to the view that the boundaries of a communication [including jurisdiction] are determined on an end-to-end basis, without regard to intermediate switching."); Verizon at 6 (agreeing that "Commission's end-to-end analysis [is appropriate] to resolve jurisdictional questions" and that "[c]alls to the Internet simply transit the ISP location on their way to their ultimate destination" and, therefore, are jurisdictionally interstate); Qwest at 3 (stating that "FCC precedent fully supports using and 'end-to-end' analysis" to determine that ISP-bound traffic is not "local" and, therefore, is jurisdictionally interstate), 4 n.3 (noting that "the D.C. Circuit never questioned the Commission's use of its end-to-end analysis to establish its *jurisdiction* over ISP-bound traffic"); USTA at 3 ("Application of the Commission's end-to-end analysis established in prior orders of the Commission support the conclusion that ISP-bound Internet traffic is jurisdictionally interstate").

As AT&T demonstrated in its opening comments, the Act gives the FCC jurisdiction over "interstate or foreign communication by wire or radio" (47 U.S.C. § 201(a)). "Wire communications" is the "transmission of writing, signs, signals, pictures, and sounds of all kinds by aid of wire, cable, or other like connection between *points of origin and reception* of such transmission, including the instrumentalities, facilities, apparatus, and *services (among other things, the receipt, forwarding and delivery of communications) incidental to such transmission.*" 47 U.S.C. § 153(52). In applying these provisions, the courts and the Commission have uniformly held that in determining whether a call is intrastate or interstate in nature, one must examine the endpoints of the communication and ignore any intermediate points of switching or exchanges. *See, e.g., New York Tel. Co.* v. *FCC*, 631 F.2d 1059, 1066 (2d Cir. 1980); *United States* v. *AT&T*, 57 F.Supp. 451, 453-55 (S.D.N.Y. 1944), *aff'd*, 325 U.S. 837 (1945).[3] Thus, under the plain terms of the Act, and the courts' and the Commission's consistent interpretations, the existence of an ISP server or other intermediate point of switching and exchange merely reflects "the receipt, forwarding, and delivery of communications incidental to such transmission" and does not result in a division of the call into separate communications for

[3] The Commission and the courts have similarly long held that the provision of enhanced or information services across state lines constitutes interstate communication by wire or radio and is within the FCC's jurisdiction. *See, e.g., AT&T* at 8-10; Amendment *of Section 64.702 of the Commission's Rules and Regulations*, 77 F.C.C.2d 384 (1980) ("*Computer II*"), *aff'd, Computer and Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983). Because ISPs are providers of enhanced or information services, the services of ISPs are unquestionably jurisdictionally interstate services. *See, e.g., MTS and WATS Market Structure*, 97 FCC Rcd. 682, 711, 715 (1983), *aff'd, NARUC* v. *FCC*, 737 F.2d 1095, 1136-37 (D.C. Cir. 1984); *Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corp.*, 7 FCC Rcd. 1619, 1620-21 (1992) ("*BellSouth MemoryCall*"); *GTE ADSL Tariff Order*, 13 FCC Rcd. 22466, 22474-79 (1998).

purposes of determining jurisdiction.[4] Under this traditional and well-established end-to-end analysis, ISP traffic is interstate.[5]

Of course, as many commenters agree, it is entirely appropriate for the Commission, pursuant to the ESP exemption, to *treat* interstate ISP-bound traffic as "local" for regulatory purposes, and to permit ISPs to purchase access out of local business tariffs regulated by the states. *See Southwestern Bell Tel Cos.* v. *FCC*, 153 F.3d 523, 541-44 (8th Cir. 1998) (upholding ESP exemption); *see also* "'Data-Relief,' 'Recip-Comp' Bills Get NARUC's Attention," Telecommunications Reports, p. 14 (July 31, 2000) (NARUC adopts resolution opposing federal legislation prohibiting reciprocal compensation for ISP traffic and noting that 38 states have ruled on the issue and 33 have found "that dialing a local number to reach an ISP will be treated like any other call to a business customer"). But the states' authority to regulate ISP-bound traffic derives solely from (and is limited to) section 251(b)(5)'s requirement that reciprocal compensation be paid for all "telecommunications" and the Commission's ESP exemption policies.

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[4] *See* USTA at 3 ("Application of the Commission's end-to-end analysis established in prior orders of the Commission support the conclusion that ISP-bound Internet traffic is jurisdictionally interstate."); *id.* at 5 ("The Commission correctly applied its end-to-end analysis in concluding that ISP-bound calls are jurisdictionally interstate); Global NAPs at iii ("the Commission retains jurisdiction over them under the end-to-end test"); Prism at 3 ("Although the one-call analysis was appropriately used to determine whether a particular communication is jurisdictionally interstate, . . . "); BellSouth at 2 ("Commission should find" that "communications and telecommunications facilities used to establish the internet connection are jurisdictionally interstate").

[5] Although that question is not (and never has been) relevant to whether reciprocal compensation applies, the Commission has already definitively – and correctly – held that ISP-bound traffic is not "telephone exchange service." *See DSL Remand Order* ¶ 15 (because "typically ISP-bound traffic does not originate and terminate within an exchange," such traffic "does not constitute telephone exchange service within the meaning of the Act"); *see also GTE ADSL Tariff Order*, 13 FCC Rcd. 22466, 22474-79 (1998).

II. SECTION 251(b)(5) REQUIRES COST-BASED COMPENSATION FOR THE TRANSPORT AND TERMINATION OF ISP-BOUND TRAFFIC.

There is also near universal agreement that the fact that ISP-bound calls are jurisdictionally interstate does not resolve the question whether cost-based reciprocal compensation obligations apply to these calls, but only establishes that this question is a question of federal, and not state, law.[6] ISP-bound calls clearly are covered by section 251(b)(5), the *federal* reciprocal compensation requirement. That is so both because section 251(b)(5)'s reciprocal compensation obligations extend to all "telecommunications" and because the policy reasons the Commission gave in its 1996 *Local Competition Order* for reading a "local" limitation into section 251(b)(5) do not apply to ISP-bound traffic.[7]

A number of commenters recognize that section 251(b)(5), by its plain terms, does not limit reciprocal compensation to "local" traffic. *See, e.g.*, Focal at 11 ("[i]n fact, § 251(b) does not limit the payment of reciprocal compensation to 'local' traffic. Section 251(b)(5) applies to all telecommunications"); Global NAPs at 6 ("[n]othing in that section limits mandatory compensation arrangements between LECs to 'local' traffic"). Rather, as AT&T explained in its opening comments (at 12-14), section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of *telecommunications*," and "telecommunications" is a defined term in the Act (47 U.S.C. § 153(43)) that encompasses

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[6] *See, e.g.*, WorldCom at 1-3; ICG Telecom at 12-13; Time Warner Telecom at 7-8; Advanced Telecom at 2-3.

[7] As AT&T noted in its opening comments, the Act separately addresses any concern that application of cost-based compensation for all telecommunications might undermine the support that access charges provide for universal service. Specifically, section 251(g) requires LECs to continue to provide access pursuant to the access charge regime and rules that existed at the time of enactment of the 1996 Act until such time as the Commission adopts superceding regulations – thereby allowing the Commission to transition access charges toward cost as it is now attempting to do with the CALLS plan and other reforms.

all dial-up ISP-bound traffic, whether local or not. Therefore, the Commission should now make clear that the same section 251(b)(5) obligation to provide cost-based compensation that all agree applies to "local" voice and data traffic applies equally to ISP-bound traffic.

The incumbent LECs insist that section 251(b)(5) compensation is available only for "local" traffic. The incumbent LECs cannot dispute that section 251(b)(5), by its terms, applies to "telecommunications" and not just "local" traffic. Rather, their only claim – and, their entire position in this proeceeding hinges on this – is that it is now too late for the Commission to construe section 251(b)(5) as written. *See, e.g.,* USTA White Paper at 2-3. But that is nonsense. It is black letter law that an administrative agency is not forever bound by its initial (mis)interpretation of a statute that it administers.[8]

Moreover, this proceeding is plainly an appropriate forum to revisit the scope of section 251(b)(5). The Commission's Notice of Proposed Rulemaking tentatively concluded that there should be a federal rule establishing an obligation to pay reciprocal compensation for ISP traffic (whether local or not), and solicited comment on "alternative proposals for inter-carrier compensation that will advance our policy goals in this area," goals that included promoting the same regime of negotiation and state commission arbitrations that occur under sections 251 and 252. *See NPRM* ¶¶ 28-33. The *NPRM* thus clearly opened the door for parties to offer any sound legal basis for a federal rule governing reciprocal compensation for ISP-bound traffic, including a rule that properly recognizes that the section 251(b)(5) obligation extends beyond "local" traffic to all "telecommunications." Even if the *NPRM* did not expressly invite comment

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[8] *See, e.g., American Trucking Ass'ns, Inc.* v. *Atchison, T. & S.F. Ry. Co.*, 387 U.S. 397, 416 (1967) (agency has both duty and authority to reinterpret its organic statute as a result of changing circumstances or experience); *ACLU* v. *FCC*, 823 F.2d 1554, 1565 (D.C. Cir. 1987), *cert. denied Connecticut* v. *FCC*, 485 U.S. 959 (1988) (commission must not "adhere blindly to regulations that are cast in doubt by new developments or better understanding of the facts").

on that question, the issue is unquestionably a "logical," if not inevitable, "outgrowth" of the issues raised.[9] Furthermore, all parties will, *in fact*, have had notice and ample opportunity in this proceeding to comment on the proper scope of section 251(b)(5).

In all events, the Commission has always *treated* ISP-bound traffic, notwithstanding its interstate character, as "local" for all purposes relevant here. The incumbent LECs offer no legitimate reason why that traffic should not be treated as "local" for reciprocal compensation purposes as well.[10] Indeed, a number of commenters note that, because ISP-bound traffic is treated as local for almost every other purpose, including tariffing, ratesetting and separations (*see* Global NAPs at 21 n.23), treating jurisdictionally interstate information services as "local" for reciprocal compenation purposes is merely "the logical extension of, and entirely consistent with, Commission precedent dating back to the ESP Exemption cases beginning in 1983 and continuing through decisions implementing the Act." Focal at 2. Pursuant to the ESP exemption the "Commission has long recognized that it may assert jurisdiction over interstate (or enhanced)

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[9] *See, e.g., Arizona Public Service Co.* v. *EPA*, 211 F.3d 1280, 1299 (D.C. Cir. 2000) (agency satisfies notice and comment requirements if "the final rule is a 'logical outgrowth' of the proposed rule"); *AT&T* v. *FCC*, 113 F.3d 225, 229 (D.C. Cir. 1997) (FCC was "free to modify its rule ... as long as the modification was a 'logical outgrowth' of the earlier version of the rule").

[10] *See, e.g.*, ALTS at 6, 11-12 (ISP-bound traffic is "local for Section 251(b)(5) purposes . . . but interstate for jurisdictional purposes"); ALTS at 12 ("dial-up ISP-bound calls, while jurisdictionally interstate are local in nature and must be subject to reciprocal compensation"); Global NAPs at 20 ("it is clear as far as the D.C. Circuit is concerned, ISP-bound calls may plainly be *both* 'interstate' for jurisdictional purposes *and* 'local' for purposes of Section 251(b)(5)"); Prism at 6 ("the Commission's classification of ISP-bound traffic as largely interstate [] does not change the reality that companies that carry telecommunications traffic deserve to be compensated for the costs of carrying that traffic"); Focal at 13 ("Just as CMRS traffic may be eligible for reciprocal compensation even though the 'termination' points of the call may vary throughout the communication, thereby removing its initial 'local' character, so too should ISP-bound traffic qualify for reciprocal compensation as 'local' traffic"); *id.* at 14 ("[T]here is no doubt that traffic may be jurisdictionally interstate yet still qualify as [local]"); Time Warner Telecom at 12 ("there is clear precedent for the fact that local service can in some circumstances be interstate in nature").

services, while ordering local regulatory treatment of component parts." *Id.* at 6. And the D.C. Circuit noted that, for purposes of the regime established by the ESP exemption in which ISP calls are treated as local, ISPs appeared to terminate at the ISP within the meaning of the FCC's rules. *Bell Atlantic*, 206 F.3d at 6-8.

The incumbent LECs' only response is a contrived attempt, in the Taylor Declaration attached to Verizon's comments, to equate dial-up ISP-bound traffic with the LEC-IXC-LEC model the Commission discussed in the *Local Competition Order*. *See* Taylor Declaration ¶¶ 13-23. But as Dr. Selwyn shows, the analogy clearly fails. *Selwyn Reply* ¶¶ 4-6. Because ISP-bound calls are "sent-paid" – *i.e.*, the caller pays the originating carrier to deliver the call to the called party – the second carrier must be compensated by the originating carrier for the work the second carrier performs in delivering the call. In the absence of the CLEC, the incumbent LEC would have to incur the expense itself to carry the call to the ISP; the CLEC is therefore performing a service for the incumbent that allows the incumbent to fulfill its contract with its end-user. Like calls that are concededly "local," the incumbent owes reciprocal compensation to the CLEC in that situation. *See Selwyn Reply* ¶¶ 4-6.

Dr. Taylor's attempts to show that economic theory establishes that the CLEC must obtain its compensation from the ISP rather than incumbent LEC are baseless. As Dr. Selwyn explains, the carrier that owes reciprocal compensation is the carrier originating the call for its end-user customer, and that is largely a matter of regulatory fiat, rather than economic reality. *Selwyn Reply* ¶ 13-22. In other words, regulators *could* have structured the ISP-bound calling situation as either an access charge regime or a dial-up regime. Since the Commission has

chosen to exempt ISPs from access charges, it is the incumbent LEC that has the relationship with the customer and must pay compensation to carriers that complete calls for that customer.[11]

III. BECAUSE LECS USE THE SAME FACILITIES IN THE SAME MANNER TO DELIVER ISP-BOUND AND OTHER VOICE AND DATA TRAFFIC, THE COMMISSION SHOULD ESTABLISH A FEDERAL REQUIREMENT OF COST-BASED COMPENSATION EVEN IF IT DETERMINES THAT ISP-BOUND TRAFFIC IS NOT GOVERNED BY SECTION 251(b)(5).

If the Commission concludes that § 251(b)(5), despite its terms, does not apply to ISP-bound traffic, it should immediately adopt a new federal rule, pursuant to its authority under §§ 201 and 202, that mandates reciprocal compensation for ISP-bound traffic at the same cost-based rates established by state commissions for the voice and data traffic that is concededly subject to § 251(b)(5). That rule necessarily follows from these facts: (1) LECs use the same networks in the same manner to deliver ISP-bound traffic as they do to deliver other voice and data traffic,[12]

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[11] Some commenters contend that section 51.701(d) of the Commission's reciprocal compensation rules, 47 C.F.R. § 51.701(d), conclusively establishes that Internet-bound calls "terminate" at the ISP and are therefore "local." But that rule in no way purports to define what traffic is "local" and what traffic is "non-local." As the *Local Competition Order* makes clear, it is subsection *(b)* of section 51.701 that purports to define what traffic is "local" for purposes of reciprocal compensation. *See Local Competition Order* ¶¶ 1033-34. And, as explained above, no such limitation to "local" traffic can be sustained, because Congress required reciprocal compensation for the transport and termination of all "telecommunications." Subsection *(d)* simply accepts the improper "local" limitation in distinguishing "termination" from "transport" for which the Commission's reciprocal compensation rules contemplate separate charges. *See* 47 C.F.R. § 51.701(c) (defining "transport"); *see also* 47 U.S.C. § 251(b)(5) (requiring reciprocal compensation for the "transport and termination" of telecommunications). Nonetheless, as many commenters acknowledge, the Commission can, pursuant to the ESP exemption, *treat* the ISP as the "called party" for purposes of its existing reciprocal compensation rule.

[12] *See, e.g.*, Cablevision Lightpath at 7-8 ("[a]s a facilities-based carrier, Lightpath utilizes the same network facilities to terminate traffic to its ISP customers that it uses to terminate any other traffic"); Time Warner at 13-14; Declaration of Lee Selwyn and Patricia Kravtin ¶¶ 22-27 (attached to AT&T Comments) ("*Selwyn/Kravtin*") ("routing a call to an originating end-user to an ISP's incoming modem line is technically identical to routing a call from the same end-user to any local telephone number served by the incumbent or other LEC"); *id.* ¶¶ 24-27 (showing that the same sequence of events occurs in the network whether the call is a voice call, data call, or call to an ISP).

(2) LECs incur real and significant costs when they deliver traffic to an ISP,[13] and (3) no commenter has demonstrated any *categorical* cost differences that could justify the categorical discrimination against ISP-bound traffic favored by the incumbent LECs.[14]

The incumbent LECs struggle to manufacture categorical cost differences that could justify disparate treatment for ISP-bound traffic. As demonstrated below, each of these "cost" arguments suffers from one or both of two fatal flaws: either the claim of reduced costs is wholly unsupported (and, in most cases, directly contrary to all available evidence) or it purports to establish a relationship – *i.e.*, long calls cost less (per minute) to deliver than short calls – that is not Internet traffic-specific and therefore could not rationally support rules that single out ISP-bound traffic for worse treatment. Even more fundamentally, however, almost all of these claims of reduced costs proceed from a flawed premise: that the relevant comparison is between what it costs a *CLEC* to deliver calls to its ISP customers and what it would cost the *ILEC* to deliver calls to those (or other) customers.[15] The Commission rejected that framework in the *Local Competition Order*, *see* 47 C.F.R. § 51.711, and for good reason.

As the Commission stated in the *Local Competition Order*, symmetrical rates for reciprocal compensation based on studies of incumbent LEC costs are appropriate to promote efficiency, to provide appropriate incentives to set reasonable and accurate rates and to equalize

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[13] *See, e.g.*, Focal at 18-19; ICG at 13; ALTS at 12; WorldCom at 36.

[14] *See, e.g.*, Cablevision Lightpath at 7-8; WorldCom at 36, 38; Focal at 20-21; Advanced Telecom at 12; ALTS at 12-13; Global NAPs at 12 n.11, 14.

[15] *See, e.g.*, Verizon at 25 ("[M]any CLECs use different, less expensive equipment, rather than costly circuit switches, to deliver calls to the Internet."); *id.* at 23 ("CLECs have developed other arrangements that further reduce their costs."); SBC at 34 (asserting that "CLECs do not have to use switch features associated with call origination when they serve their ISP customers" and, thus, have deployed "new types of switches that are designed specifically for one-way ISP traffic."); BellSouth at 14-15.

bargaining power between incumbent LECs and CLECs. *See Local Competition Order* ¶¶ 1085-89; Cablevision Lightpath at 9-10. As Dr. Selwyn explains (*Selwyn Reply* ¶¶ 23-37), basing reciprocal compensation rates on the ILECs' costs (subject to applicable forward-looking constraints) facilitates local competition, by giving CLECs an incentive to provide transport and termination services more efficiently than the ILEC. By requiring symmetrical rates, the Commission has established a system that closely mirrors the operation of a competitive market. *Id.*

Although AT&T (and presumably other broad-based CLECs) generally do not employ the particular equipment or practices that the incumbent LECs identify as ISP-specific, *see* Verizon at 23-25, the fact that some CLECs may have found ways of providing termination more efficiently is simply an indication that the incentives built into the Commission's reciprocal compensation rules are working as intended. *See, e.g.*, Time Warner at 15 (CLECs are appropriately responding to the incentive to reduce costs); Focal at 21; Cablevision Lightpath at 9-10; WorldCom at 37. The incentives also work the other way: ILECs are encouraged to find ways to provide termination more efficiently as well. Indeed, ILECs have begun to deploy "Central Office Based Remote Access" architecture ("COBRA"), which allows the *ILEC* to reduce its costs of terminating ISP traffic. COBRA allows the ILEC to place Network Access Servers in the Central Office, so that an ISP can simply purchase modem ports instead of circuits from the ILEC. As Dr. Selwyn explains (at ¶¶ 29-30), "when ILECs know that they have to pay CLECs to deliver ISP-bound calls, and they know that they cannot isolate the rate applicable to such calls from the rate they receive for local calls they terminate, they have strong incentives to lower the general call termination rate, which enhances the prospects for broad-based competition for the local exchange business of all classes of customers. The Commission,

therefore, should be extremely skeptical of any proposal that would create some special, low rate for ISP-bound calls as a class."

But even if the incumbent LECs' disregard of the Commission's core symmetry rules could be sanctioned, they have failed to establish any categorical cost differences that could warrant disparate treatment for ISP-bound traffic. For example, incumbent LECs repeat their claims that CLECs' per-minute costs of terminating ISP-bound traffic are lower because ISP calls have a longer call duration than the average voice call. *See* Taylor Declaration ¶¶ 25-27 (attached to Verizon Comments); Verizon at 26-27; SBC at 35; BellSouth at 10. The LECs have produced no *evidence* that call duration differences of the magnitudes at issue here have any significant impact on the relevant costs. As AT&T demonstrated in its opening comments, Dr. Taylor's speculation that there *may* be significant cost impacts ignores both the magnitudes of the relevant fixed and traffic-sensitive costs and an important offsetting factor – *i.e.*, that reciprocal compensation rates based on ILEC costs will reflect economies of scale and other cost savings that CLECs cannot achieve. *See Selwyn/Kravtin* ¶¶ 38-42.

More fundamentally, call duration is simply not an Internet-specific issue and therefore could not rationally serve as a basis for singling out ISP-bound traffic for disparate reciprocal compensation treatment. There are short and long voice calls, and there are short and long Internet sessions. *If* call duration differences have a significant cost impact, then *all* long calls – and not just long Internet calls – will cost less per minute to deliver. Thus, if call duration is to be taken into account – through, for example, a bifurcated rate structure that includes a "set-up" charge in addition to per minute charges – the bifurcated rates must apply across the board to all voice and data traffic. Sprint proposes that the Commission make "one refinement to the current rules that . . . should be applied to *all types of traffic*, including both voice calls and calls to

ISPs: The reciprocal compensation rate for switching should be bifurcated into a fixed call setup charge and a separate per-minute charge." Sprint at 3 (emphasis added).[16] Although the ILECs have not demonstrated a need to adopt a different rate structure, the Commission's existing reciprocal compensation rules under § 251(b)(5) *already* allow state commissions to do so, including requiring bifurcated rates if appropriate. *See* 47 C.F.R. § 51.709 ("a state commission shall establish rates for the transport and termination of local telecommunications traffic that are structured consistently with the manner that carriers incur those costs"). If reflecting call duration-related cost differences in reciprocal compensation rates is indeed worth the candle (which will have to be proven in individual cost proceedings on the basis of competent evidence),[17] the solution is to shift to a rate structure that would make reciprocal compensation more economically efficient for *all* calls, not to single out ISP-bound traffic. *See also* Advanced Telecom at 13 (varying rate structures "must be made on the basis of the call characteristics of the traffic involved and not on the identity of the end-user").[18]

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[16] It is far from clear that there is any cost basis for bifurcated rates. Although the proprietary SCIS and NCAT models that the incumbent LECs typically use have historically provided output detail that allow bifurcated rates to be developed, such rates reflect an outdated assumption that adding call set-ups to the processing capacity can exhaust the switch and or its subcomponents. This simply is not true of the current generation of digital switches, which typically use less than half of their processing capacity (both central and distributed). These modern switches generally will exhaust on the number of lines and trunks long before they could ever exhaust on call processing capacity.

[17] As a recent state proceeding that examined these issues confirms, a per-call setup charge based on forward-looking economic costs, if justified at all, would be quite small. Arbitration Award, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, Docket No. 21982, p. 49 (Pub. Util. Comm'n of Texas, July 12, 2000) (adopting a per-call rate of $0.0010887).

[18] The commenters also agree that any compensation scheme that required carriers separately to identify, measure, and bill for ISP-bound traffic would be unjustifiably costly and time-consuming. *See, e.g.*, ALTS at 9 n.23; Arbitration Award, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, Docket No. 21982 (Pub. Util. Comm'n of Texas, July 12, 2000).

Nor could Dr. Taylor's unsupported claim that the cost of delivering ISP-bound traffic is lower because ISPs use dedicated ISDN connections (which impose only non-traffic-sensitive costs) serve as the basis for a categorical rule that ISP-bound traffic is deserving of lower (or no) reciprocal compensation. Taylor Declaration ¶¶ 28-30. Although some CLECs and ISPs may use such facilities in some circumstances – and the incumbent LECs have produced no evidence of the prevalence of that approach – that would not be a justification for changing the reciprocal compensation rules or exempting ISP-bound traffic. ISPs, like pizza parlors and many other businesses that receive more calls than they make, may benefit from special facilities arrangements, but the Commission has never endorsed special compensation rules merely because a subset of traffic is provisioned differently and it would therefore be patently arbitrary to punish Internet traffic (and, ultimately, Internet users) in this way. Moreover, as Dr. Selwyn explains (at ¶ 32), nothing prohibits the ILECs from aggressively competing with CLECs for the business of ISP customers and deploying the same or similar efficient cost-reducing measures to reduce their own costs of delivering traffic to those customers.

The incumbent LECs next speculate that ISP-traffic will be off-peak traffic that is less costly to deliver because it will not impact peak "busy-hour" capacity needs. *See* Taylor Declaration ¶¶ 32-33. Once again, Dr. Taylor's theory is supported by no facts. And, as Dr. Selwyn showed, at least for the Internet-focused CLECs that are the principal targets of Dr. Taylor's analyis, the reality is likely precisely the opposite of Dr. Taylor's prediction. If, as Dr. Taylor appears to concede, Internet traffic peaks at particular hours (albeit not the traditional voice busy hours), those Internet peaks *are* the busy hours for an Internet-focused CLEC and thus will be that CLEC's most *expensive* traffic to deliver. *See Selwyn/Kravtin* ¶¶ 32-35. In all events, Dr. Taylor again ignores offsetting factors – *e.g.*, that CLECs generally will have *higher*

terminating costs on average than ILECs (because of differences in the architecture and scale economies of incumbent LEC and CLEC networks). *See id.* ¶¶ 38-41. Moreover, the incumbent LECs will have a much broader distribution of types of traffic – going in both directions and distributed over a broader portion of the day – and thus will be able to spread the costs of their investment in network facilities over a greater amount of traffic, resulting in lower costs per minute.

The incumbents' claim that reciprocal compensation for ISP-bound traffic must be denied to all because there are some "sham CLECs" is easily dismissed as a classic plea to throw out the baby with the bath water. *See, e.g.*, Verizon at 16-17; SBC at 38-39; *id.* at 45 (referring to annual reciprocal compensation "kickbacks" and asserting that ISPs "become CLEC's and take full advantage of the reciprocal compensation opportunity"). As the Commission recognized in the *Declaratory Ruling*, "the state commissions are capable of assessing whether and to what extent these and other anomalous practices are inconsistent with the statutory scheme (*e.g.*, definition of a carrier) and thereby outside the scope of any determination regarding inter-carrier compensation." *Declaratory Ruling* at ¶ 24 & n.78. Moreover, LECs are free to negotiate, and arbitrate, provisions in their interconnection agreements designed to prevent clear abuses.[19]

The incumbent LECs' complaints about "virtual NXXs" are likewise irrelevant to the question of reciprocal compensation. These local serving arrangements provide an economically

[19] ILECs are fond citing the well-publicized incident in North Carolina in which US LEC attempted to abuse its right to collect reciprocal compensation by installing routers on customres' premises that were that were configured for the sole purpose of establishing dial-up Internet connections that would be used to stimulate outbound minutes of use and thereby increase US LEC's reciprocal compensation from BellSouth. Rather than justifying the need for federal intervention, however, this incident simply illustrates that the states are capable of addressing such abuses. The North Carolina PUC sanctioned US LEC and ordered it to refund the unlawful charges to BellSouth, and BellSouth recently has begun to negotiate language in interconnection agreement to clarify that such traffic is not compensable.

efficient way for a CLEC to offer customers local service without having to duplicate an ILEC's embedded network architecture.

AT&T, for example, seeks to deploy a symmetrical network interconnection architecture with incumbent LECs under which AT&T normally has two[20] or more points of interconnection ("POIs") in each LATA that it wishes to serve for the purpose of receiving traffic originated by the incumbents' customers, and which allows the incumbent a comparable number of POIs for the purpose of receiving traffic originated by AT&T customers. These POIs allow AT&T to exchange local traffic – including non-ISP bound traffic – with the incumbent on a financially comparable basis, requiring each carrier to interconnect at the same relative point on the network of the other carrier. Such an arrangement avoids the need for AT&T to replicate the incumbent's network, yet allows efficient trunking to each and every incumbent end office where traffic volume justifies direct trunks. Moreover, such an arrangement avoids the need for AT&T to collocate or deploy equipment in each local serving area.[21] At the same time, this arrangement permits the incumbent to realize similar efficiencies.

Where these equivalent interconnection arrangements are in place, AT&T often provides a local serving arrangement to customers with high inbound local calling requirements, such as travel agencies, pizza delivery companies, and ISPs, that allows traffic to be routed through

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[20] Unless a de minimis volume of traffic exists between AT&T and the ILEC, AT&T would prefer to have at least two POIs in each LATA for network redundancy. These POIs are normally located at each AT&T switching center in the LATA or, if there is no AT&T local switch in the LATA, at one or more AT&T-specified facilities within the LATA.

[21] As the Commission recently emphasized, "a competitive LEC has the option to interconnect at only one technically feasible point in each LATA" so that CLECs "may select the 'most efficient points at which to exchange traffic with incumbent LECs . . . .'" *Application by SBC Communications, Inc., et al., Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas*, CC Docket No. 00-65, FCC 00-238, Memorandum Opinion and Order, ¶ 78 (rel. Jun. 30, 2000).

AT&T's network to a centralized customer location. When used for ISPs, this efficient serving arrangement imposes no additional costs on the incumbent, because the incumbent delivers all traffic (*i.e.*, ISP-bound and other local traffic) destined to the same NPA-NNX to the same POI. AT&T provides the switching and transport necessary to carry the traffic to the customer location, wherever it may be located. Thus, whether local calls are being made to a credit card validation center, a taxi service or an ISP the incumbent would deliver the traffic to the identical AT&T POI.[22]

The fact that the CLECs are able to provide local service to their customers more efficiently in no way undermines the CLEC's right to be compensated by the originating carrier for terminating calls to its customers. Indeed, shifting those costs onto the CLEC, by denying reciprocal compensation for calls routed using these local serving arrangements, would undermine the efficiencies gained by the CLEC, and put at risk the viability of more efficient network designs and the widespread deployment of new services such designs make possible, including economically attractive dial-up Internet access, especially in rural areas. CLEC deployment of centralized local serving arrangements has permitted ISPs to offer dial-up access throughout the United States. Incumbent LECs oppose such efficient arrangments only to raise barriers to competitive entry by forcing competitors to replicate the incumbents' existing network design – thereby mandating CLEC investment in unnecessary, inefficient and under-utilized facilities.[23] Imposition of such a requirement would significantly lengthen the time (and

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[22] This arrangement is reciprocal, meaning that AT&T would be financially responsible to switch and transport its originating traffic to the ILEC POI applicable to the terminating NPA-NXX, regardless of the physical location of the terminating customer.

[23] The relevant inquiry under existing FCC rules is whether the ILEC is rating the traffic handed off to a terminating CLEC as local, in which case the terminating CLEC is entitled to reciprocal compensation payment, or the ILEC is rating the traffic as toll, in which case the terminating CLEC may be entitled to compensation payments in the form of access charges. In this instance,

money) required for broad facility-based market entry, and would discourage or eliminate CLECs altogether from providing an affordable local service alternative for customers like ISPs that are trying to serve customers over a broad geographic area, including sparsely populated suburban or rural areas.

In the end, recognizing that they have failed to establish any categorical cost differences that could justify treating ISP-bound traffic differently from all other voice and data traffic, the incumbent LECs resort to claims that the sky will fall unless their ISP-bound calls get a free ride on their competitor's networks. Thus, Dr. Taylor, for Verizon, claims that cost-based reciprocal compensation for ISP-bound traffic has the unseemly effect of dissuading CLECs from competing for residential consumers. That is clearly wrong for at least two reasons. First, the amount of capital potentially available to CLECs for investment in local exchange markets is not fixed (as Dr. Taylor's "analysis" necessarily assumes); CLECs will find capital to enter in *any* segment of the local market that is profitable. Thus, if the residential market is profitable as an absolute matter (even if less profitable than the inbound call termination business), entry will occur, regardless of reciprocal compensation payments for ISP-bound traffic.

To be sure, "[t]o the extent that ISP-bound calls are treated as local calls as far as the end user is concerned, it is obvious that an increase in calls to ISPs — just like any other increase in calls — is not cost-free to the LEC serving the end user, whether that LEC terminates ISP-bound calls directly on its own network or hands them off to one or more CLECs for termination." *Selwyn Reply* ¶ 43. As Dr. Selwyn points out, however, this complaint has nothing to do,

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even under the FCC's existing rules, the traffic is clearly defined as local by the ILECs' own tariffs and subject to reciprocal compensation. Under the proper interpretation of Section 251(b)(5) described in AT&T's Comments, such traffic plainly constitutes "telecommunications" that is not subject to the access charge regime, and accordingly must be compensated on a

economically, with reciprocal compensation for ISP-bound calls. To the extent the carrier's retail service charges are flat (or minimally usage sensitive), while costs are not (or at least not to the same extent), a change in customer calling patterns leading to more and longer calls to ISPs will increase the ILEC's costs and decrease its profit margins from its residence customers. This does not indicate any defect in cost-based reciprocal compensation payments for ISP traffic, however, because the very same issue arises whenever reciprocal compensation applies to calls to any other type of firm that receives a lot of traffic. Therefore, Taylor's argument, if taken to its extreme, would eliminate reciprocal compensation entirely, since payment of such compensation, on his theory, necessarily "distorts" competition for any customer who makes a lot of calls to any location where reciprocal compensation applies.

Second, incumbent LECs ultimately cannot escape the costs of terminating ISP-bound traffic by eliminating reciprocal compensation. CLECs may be more efficient at providing the terminating function, but if CLECs cannot get paid by the ILEC for the function of delivering ILEC-originated calls to ISPs, then CLECs will be forced to raise their ISP prices to a level that would recover incoming usage costs from the ISP (which, if sustainable, would also raise the prices ISPs charge consumers for Internet service). But that would make CLEC services relatively unattractive, and thus these price increases would simply drive ISPs back to the ILECs, who would then be saddled with the costs of delivering ISP-bound calls. At the end of the day, the ILECs would still be paying the costs of termination, but at the cost of competition in the local service market. As Dr. Selwyn aptly states (at ¶ 47), "the costs of delivering calls to ISPs are real, and cannot be made to disappear by manipulating the rules for reciprocal compensation."

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reciprocal compensation basis. Thus, whether the traffic routes to the CLEC in a manner akin to

In short, the record in this proceeding provides ample support for the rule AT&T has proposed:

> The rates, terms, and conditions for the transport and termination of ISP-bound traffic between any two carriers in a state shall be the rates, terms, and conditions established or approved by the state commission in such state (or the parties through negotiation) for the transport and termination of local traffic between the two carriers, in accordance with Section 252 of the Act.

The commenters agree that a national rule is necessary to reduce the transaction and litigation costs of entry and to promote regulatory certainty.[24] The commenters similarly agree that reciprocal compensation disputes should continue to be aired in the state commissions pursuant to Section 252.[25] Finally, the commenters confirm that the Commission should ensure that any rule changes adopted in this proceeding will have no retroactive effect on existing interconnection agreements and arbitrated decisions concerning reciprocal compensation arrangements.[26]

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some other retail service offered by the ILEC (or even the CLEC) is of no consequence.

[24] Verizon at 1 ("Verizon urges the Commission to adopt a rule that puts to an end the controversy and litigation surrounding compensation arrangements for traffic to the Internet"); RNK at 9 (urging that the "FCC is responsible under the Act *not* to relegate interconnection agreements and compensation to an as-yet unrealized open market"); Global NAPs at 35 (emphasizing need for "clear delcaration by [the] Commission"); Advanced Telecom at 12 ("the CLEC Coalition strongly supports the adoption of additional reciprocal compensation rules designed to provide business certainty and eliminate many of the potential battles facing LECs in ongoing and upcoming proceedings before state commissions"); Qwest at 17 ("The Commission should make clear as it goes forward what compensation rule will apply to this [ISP-bound] interstate traffic"); Mass. PUC at 2 ("we respectfully urge the Commission to be very direct, clear, and specific as to how its decision on remand affects the jurisdiction and scope for action s of state utility commissions").

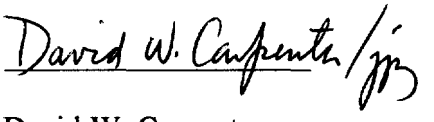
[25] *See e.g.*, WorldCom at 39; Public Util. Comm'n of Texas at 5.

[26] *See, e.g.*, Cablevision Lightpath at 16-17 (urging the Commission "to follow the NY PSC's" example and "not to modify existing contractual provisions governing reciprocal compensation except to the extent those contracts expressly and unambiguously contemplate modification of reciprocal compensation based on future changes in law").

CONCLUSION

For the foregoing reasons, the Commission should require cost-based reciprocal compensation for ISP-bound traffic on a uniform basis with other voice and data traffic.

Respectfully submitted,



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August 4, 2000

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	CC Docket No. 96-98
Inter-Carrier Compensation for ISP-bound traffic	CC Docket No. 99-68

COMMONWEALTH OF MASSACHUSETTS)
) ss.
COUNTY OF SUFFOLK)

REPLY AFFIDAVIT OF LEE L. SELWYN

Lee L. Selwyn, of lawful age and being first duly sworn on oath, deposes and says as follows:

1. My name is Lee L. Selwyn. I am President of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108. Economics and Technology, Inc. (ETI) is a research and consulting organization specializing in telecommunications economics,